

BEAUTY IS IN THE EYE OF THE TAXPAYER

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INTRODUCTION

In “[Tax Competition Between Member States of the European Union – an Academic View](#),” which appears earlier in this edition of *Insights*, Professor Boria analyzed the history and political ideologies that led to the view that all tax benefits offered companies as an inducement to locate a business value driver in a particular Member State of the European Union are examples of harmful tax competition constituting unlawful State Aid. He concluded,

* * * the notion of harmful tax competition among Member States [of the European Union] developed, looking at tax competition as an inappropriate lever to distort normal market logic. Under this view, the harm results from the selective process of determining which industries will benefit from a reduction in effective tax rates.

By and large, this view is not shared by State governments in the U.S., where tax competition has provided benefits to States and their residents. States have an obligation to balance attractiveness with actual attraction when implementing competitive tax policies. It is only when competitive tax policies fail to deliver new businesses, new private investment, and new residents that the policy falls short.

For many years, residents and businesses have made decisions regarding where to live, where to work, and where to invest based on self-interest, including tax competition between States. To an extent, the Tax Cuts and Jobs Act amplified tax competition due to limitations imposed on individuals wishing to deduct State and local taxes.¹ While income tax is not the only factor that drives a decision on where to live or invest, it is a key consideration when individuals and entities plan their futures.² Tax competition provides a way for States to increase revenue by attracting new businesses and residents. It is a decision influenced by the ends, rather than the means.

TAX ATTRACTIVENESS: MOVEMENT AND CONSEQUENCES

Under the Tenth Amendment, States are granted a general police power to preserve public health, safety, and general welfare of their populations. The amendment has also been interpreted to create an ethical obligation for States to do so.

¹ [“How Did the TCJA Change the Standard Deduction and Itemized Deductions?”](#) Tax Policy Center (Nov. 29, 2020, 11:36 PM).

² Carly Stern, [“Why People Are Flocking From California to Arizona.”](#) OZY (Nov. 29, 2020, 11:39 PM).

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Tax attractiveness has become a tool in fulfilling the obligation when more revenue becomes available for investment in State-funded projects.

By reducing tax rates and providing incentives, States can increase their attractiveness to new businesses and residents. This may seem counterintuitive if the goal is to raise more revenue. However, if the State is attractive and more taxpayers are driven to the State, the reduction in tax can lead to an increase in State revenue. When businesses move into a State or expand, society recognizes certain benefits, such as job creation. Thus, the benefits of reduced rates and additional incentives may exceed any losses.

Recent census results in the U.S. indicates citizens have been migrating from higher taxed States to those with more favorable tax policies. In that regard, the Wall Street Journal recently commented that “[f]or the past several years, Wall Street has been colonizing [Florida], attracted to more favorable tax policies and sunnier climes.”³ Aside from New York, California has also seen a large exodus of residents to Arizona and Nevada.⁴

In 2019, the Arizona Department of Revenue’s annual report showed that \$19.3 billion of gross revenue was collected.⁵ This is a 23.7% increase from the gross revenue reported in 2017.⁶ When comparing the 2017 and 2019 reports, one will notice a nearly \$1 billion increase in revenue collected through individual State income and wage withholding tax. According to North American Moving Services, Arizona remained a popular inbound State and California remained a leader for outbound migration during the same period.⁷ While tax may not be Arizona’s only attractive factor, it is an undeniably important one that influenced many Californians to move.

While these movements increase revenue for inbound States, some consequences may be negative. Political climates of destination States may shift.⁸ More students may require an increase in education-related spending and the need for financial assistance.

ALABAMA, THE BEAUTIFUL

I was brought up in the State of Alabama. Alabama has an abundance of natural resources and a lower unemployment rate than the national average. However, it suffers from a higher poverty rate than the national average. The State has not adopted a minimum wage. So, employees can be paid as little as \$7.25, but a dollar in Alabama goes much further than it does in New York. As is the case with every

³ Katherine Clarke & Cara Lombardo, [“As Wall Street Migrates to Florida, Hedge-Funders Move to Offload Manhattan Homes.”](#) *The Wall Street Journal* (March 3, 2021, 3:29 PM).

⁴ Sarah Holder, [“Is the ‘California Exodus’ Turning Arizona Blue?”](#) *Bloomberg CityLab*, (March 3, 2021, 3:34 PM).

⁵ Arizona Department of Revenue, Annual Report Fiscal Year 2019 (2019).

⁶ Arizona Department of Revenue, Annual Report Fiscal Year 2017 (2017).

⁷ [“Where Are Americans Moving?”](#) *North American Moving Services*, (March 3, 2021, 4:01 PM); See also Micah Alise Bledsoe, [“California’s Cost of Living Pushes People to Arizona.”](#) *Southern California Public Radio*, (March 3, 2021, 4:01 PM).

⁸ See Holder, note 4.

“In order to increase revenue, it is imperative for Alabama to attract residents in order to encourage growth in economic activity.”

State, it has both attractive and unattractive qualities that businesses and individuals may consider when planning their futures.

Alabama has one of the lowest property taxes in the nation.⁹ Revenue raised through property taxes account for less than 5% of the State’s gross revenue. In comparison, sales tax and income tax account for 86% of the revenue collected in 2020.¹⁰ In order to increase revenue, it is imperative for Alabama to attract residents in order to encourage growth in economic activity.

According to United Van Lines’ National Migration Study, Alabama had a higher percentage of inbound movement than most other States during 2020.¹¹ Job opportunity is one of the main factors driving persons to move to the State.¹² While an individual may need to accept lower wages in Alabama, she may prefer job security over potential unemployment in another State. In any event, it is a personal choice for the individual.

In recent years, Alabama has seen an influx of foreign direct investment that has led to thousands of jobs. Since 2013, foreign companies have announced \$16 billion in new capital investments.¹³ In early 2019, Alabama offered Hyundai an investment credit of \$58.2 million over ten years and a jobs credit of almost \$1 million over ten years.¹⁴ Later that year, Hyundai announced it put \$292 million towards new equipment and machinery at its Montgomery plant.¹⁵ Foreign companies are actively choosing to invest and create jobs in Alabama.

While Alabama has been experiencing significant inbound movement, it nonetheless actively works to further increase its tax competitiveness. On February 12, 2021, Governor Kay Ivey signed House Bill 170 into law, which enacted more competitive tax legislation. In her Statement regarding the bill, she said,

Thanks to [the Alabama Legislature’s] work, the people of Alabama who received any type of CARES Act dollars will not pay one penny in State income taxes on that relief. Additionally, we are ensuring that our State will continue to grow our diverse economy, and we are protecting our existing businesses from any frivolous lawsuits due to COVID-19.

This bill also retroactively excluded G.I.L.T.I. from taxation, repealed its throwback rule, and created a workaround the U.S. tax law provision that capped deductions for State and local taxes. One commentator stated the following regarding the tax policy of Alabama:

⁹ [Taxes In Alabama.](#) Tax Foundation (March 4, 2020, 11:31 AM).

¹⁰ Alabama Department of Revenue, 2020 Annual Report (2021).

¹¹ [“United Van Lines’ National Migration Study Reveals Where and Why Americans Moved in 2020.”](#) *United Van Lines* (March 3, 2021, 4:38 PM).

¹² *Id.*

¹³ Jerry Underwood, [“Foreign Investment Sparks Growth in Rural Alabama Communities.”](#) *Made In Alabama* (March 3, 2021, 4:45 PM).

¹⁴ William Thornton, [“State Offered \\$59 Million in Incentives to \\$388 Million Hyundai Project.”](#) *AL.com* (March 4, 2021, 4:39 PM).

¹⁵ William Thornton, [“Alabama Gets Top Marks for Foreign Investment.”](#) *AL.com* (March 3, 2021 5:20 PM).

Repealing the State's throwback rule and excluding GILTI from taxation are both significant changes that will benefit the State's competitiveness, and the exemption of relief payments is an important clarification that will benefit those struggling in the midst of the pandemic.¹⁶

Governor Ivey made Alabama more beautiful with a simple signature.

Through tax competition, Alabama can attract new businesses and residents that may have otherwise chosen another State. However, there are still disparities in the State, despite its attractiveness. Revenue in the State has steadily risen over recent years, but Alabama remains one of the poorest and most uneducated States in the Union. Perhaps tax competition has not failed the people of Alabama, but rather the State's spending has failed them.

UNATTRACTIVE SPENDING

Alexander Hamilton wrote,

I believe it may be regarded as a position, warranted by the history of mankind, that in the usual progress of things, the necessities of a nation, in every stage of its existence, will be found at least equal to its resources.¹⁷

Where there are needs in society, it is the responsibility of the government to ensure they are met. Meeting the needs of citizens requires both appropriate tax policies and spending.

Alabama's 2021 State Budget Report shows that education accounted for 2.44% of the State's total budget during the 2019 fiscal year. In comparison, corrections accounted for 10.61% of the State's budget during that same fiscal year. One may argue that corrections requires more funding due to the high rate of incarceration, but this may be a problem Alabama Legislators created. On this point, one commentator wrote the following:

[The rate of incarceration] has grown exponentially over the last 40 years, driven in part by the State's adoption of—and prosecutors' subsequent reliance on—the Habitual Felony Offender Act.¹⁸

Laws like the Habitual Felony Offender Act led to harsher, taxpayer-funded sentences.

While the State allocates a hefty chunk of its budget to corrections, Alabama school systems are forced to rely on other sources of revenue. For instance, enrollment in the Phenix City school system has grown and is expected to continue to grow. Expansion and new hires will be required to meet the needs of the growing student

¹⁶ Janelle Cammenga, "[Alabama Passes Tax Reform Aimed at Throwback, GILTI, and More.](#)" *Tax Foundation* (March 3, 2021 5:34 PM).

¹⁷ Alexander Hamilton, "Concerning Taxation," in *The Federalist* 158, 161 (Barnes & Noble Classics ed., 2006).

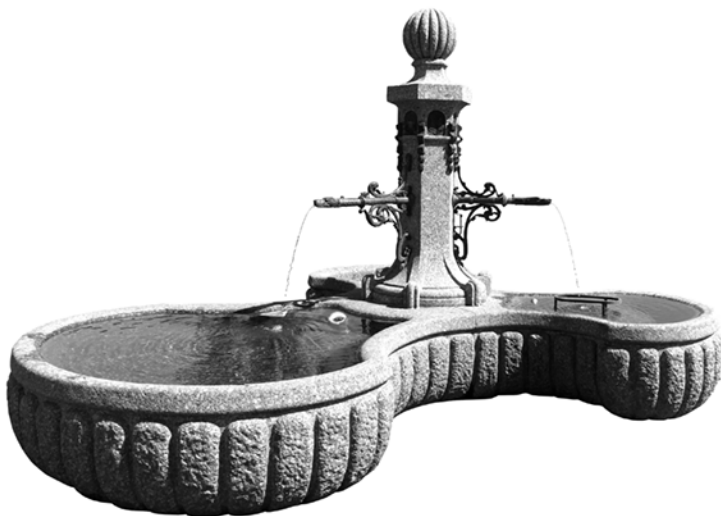
¹⁸ John Fowler, "[To Address the Alabama Prison Crisis, Put an End to Over-Incarceration in the State.](#)" *Injustice Watch* (March 4, 2021 12:02 PM).

body. The Phenix City school system has plans for capital projects, which will use a combination of State and local funding.¹⁹

The Alabama resident has little control over the cracks in the walls of her child's public school and the child's textbooks that have been used and re-used for years, but she has control as to whether she will stay in or leave Alabama. When her tax money is no longer being used by the State to meet the needs that matter to her most, she may leave. Alabama may be a beautiful State, but its spending may be unappealing for some.

CONCLUSION

Tax competition is not exclusively harmful. States make themselves attractive to new businesses and residents by reducing rates and adding incentives to their respective tax codes. If more revenue has been raised through competitive tax policies, then States are acting ethically by implementing competitive tax policies with the intention of increasing revenue. The unanswered question is how the funds are spent. California and New York are high tax and high spending States. As indicated by loss of residents; it is not clear whether residents get as much value for money as residents elsewhere in the country.



¹⁹ Mark Rice, [“Two More Phenix City Schools to be Expanded. Here’s the Plan for Additional Projects.”](#) *Ledger-Enquirer* (March 4, 2021, 12:37 PM).

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